No. 15040

IN THE

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

D. M. HAGGARD AND NILA HAGGARD,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR PETITIONERS

On Petition for Review of the Decision of The Tax Court of the United States

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W. LEE MCLANE, JR.
NOLA MCLANE
806 Security Building
Phoenix, Arizona
Counsel for Petitioners

MCLANE & MCLANE
806 Security Building
Phoenix, Arizona
Of Counsel

SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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ARGUMENT

I

Respondent's brief offers one major argument in support of the Tax Court's decision herein. It is that whether a taxpayer is paying rent or making an investment in the property is a question of the intention of the parties and is therefore one of fact and should not be disturbed unless clearly erroneous (Br. 7).

From such a premise it is then urged that there was *ample* evidence to support the Tax Court's finding that both parties intended, and taxpayer did in fact, acquire a substantial equity as a result of the "rental" payments (Br. 7-8).

Such a contention ignores (1) the quality of evidence upon which the findings of fact are based, (2) the weight of the evidence, and (3) whether the findings, as petitioners urge, were the result of an erroneous view of the law. In short, it avoids this Court's ruling that:

> "A finding of fact is clearly erroneous when, *even though there is evidence to support it,* the appellate court on the entire record is left with the definite and firm conviction that a mistake has been committed. *Gillette's Estate v. Commissioner,* 9 Cir., 1950, 182 F. 2d 1010, 1014."

Stated in another fashion by the U.S. Court of Appeals for the Sixth Circuit in *Wright Bernet, Inc. v. Commissioner,* 6 Cir., 1949, 172 F. 2d 343, 345:

> " . . . The findings of a fact of the court below to the extent that they are unsupported by substantial evidence or are clearly against the weight of the evidence, *or were induced by an erroneous view of the law,* are not binding upon this Court."

Since petitioners specification of error No. 10 urged that the "Tax Court erred in that its decision is not supported by the evidence, is clearly erroneous, and is not in accordance with law," it hardly seems a sufficient answer to say there is "ample evidence" in the record to support the Tax Court's finding that the parties intended, and the taxpayers in fact, acquired a substantial equity by means of the rental payments (Br. 7, 8).

But what of the major premise itself? Is it correct to say that whether the taxpayer is making an investment in the property is a question of the intention of the parties and therefore a determination of fact? Not according to this Court's opinion in *Oesterreich v. Commissioner,* 9 Cir., 1955, 226 F. 2d 798, a case cited repeatedly by respondent in his brief. In that opinion, it was said:

> "We are of the opinion that the Tax Court erred in treating the question of intention of the parties as one of fact collateral to the written instrument. The document was not ambiguous, and evidence as to surrounding circumstances was not required to explain it. The intention of the parties, *as expressed in the instrument* was cardinal, as has been construed in the light of the applicable statute. *No question of fact was involved . . .*" *Oesterreich v. Commissioner,* supra at 803.

Thus, when respondent relies on the *Oesterreich* case, supra, followed by 14 pages of argument reviewing the Tax Court's findings of fact collateral to the instruments (Br 8-21), he is doing precisely what this Court says is error. Consequently, the respondent's defense that the question of intention is one of fact which cannot be disturbed is difficult to accept in the face of the above quoted language that no question of fact was involved. Nor do the other two cited cases from this Court support the proposition that:

> "This question of intent is clearly factual *and* findings and inferences of fact made by the Tax Court will not be disturbed unless clearly erroneous. *Pacific Homes v. United States,* 230 F. 2d 755 (C.A. 9th); *Ward v. Commissioner,* 224 F. 2d 547 (C.A. 9th); . . . " (Br. 9).

It is true that each of the two cited cases from the Ninth Circuit sustain that portion of respondent's above sentence following the word "and" stating that findings of fact are not disturbed unless clearly erroneous. The proposition that the question of intent is factual was not before the Court in either case. In the *Pacific Homes* case, supra, the issue was whether a corporation held real property primarily for sale to customers in the ordinary course of its trade or business. In *Ward v. Commissioner,* supra, the question was whether upon a sale incidental to the dissolution of a partnership, the distributive shares are ordinary income or capital gain. Each case held that the Court would not disturb a finding of fact of the lower court unless clear error appeared or the finding was clearly erroneous. However, neither case is authority for the complete sentence stating the principle that the

question of intent is clearly factual *and* findings and inferences of fact will not be disturbed unless clearly erroneous.

Petitioners submit that while respondent has adopted certain language from the *Oesterreich* case, supra, the holding itself actually supports their contention that the Tax Court misapplied the law. In the *Oesterreich* case, supra, the "lessee" agreed to pay "lessor" $679,380.00 in monthly installments over a period of 67 years and eight months after the payment of which he could acquire fee title by the additional payment of $10. This Court held that the intention of the parties according to the instrument was to effectuate an installment sale. But what are the facts in the instant case? Petitioners paid $22,000. in "lease" payments during 1948 and 1949, and were required to pay $24,000. in 1950 if they wished to purchase the real property. The cases are simply not analogous. In fact, the *Oesterreich* decision, supra, was distinguished by the Seventh Circuit in *Breece Veneer & Panel Co.,* 7 Cir., 1956, 232 F. 2d 319 because of this great difference.

In this regard, respondent has, on page 20 of its brief, quoted from *Watson v. Commissioner,* 9 Cir., 1932, 62 F. 2d 35 to buttress the view that the parties intended a sale. After pointing out that the rent paid by petitioners amounted to 46% of the total considerations, the following quotation from the *Watson* case, supra, appeared:

> "It is unthinkable that the payment of $47,000 which is about 43 per cent of the entire consideration, upon property valued at $109,900 is an *annual* rental, for that is the approximate amount recevied by the "lessor" during the year 1924. (Emphasis supplied.)

This is like trying to analogize Miss Marilyn Monroe with Carrie Nation or the campaign techniques of ex-President Harry Truman with those of ex-President Calvin Coolidge. How can respondent compare an *annual* rental constituting 43% of the total consideration *(Watson v. Commissioner)* with an annual rental of $12,000 or 25% of the total consideration paid in this

case. The answer is that he does not. Instead, he has compared an annual rental of 43% paid in *Watson v. Commissioner* with "the rental payments" of $22,000. paid in this case over a period of *two* years. Here the annual rental which was paid for 1949 constituted only 25% of the total consideration of $48,000. Is it "unthinkable" that a farmer would pay 25% of $48,000 (the fair market value of the property as determined by the Tax Court) as rent? In view of the following factors, petitioners submit that a negative answer is proper.

In response to questioning from the trial judge, Wayne M. Akin, the only expert on the fair market value of the subject real property who testified, stated as follows:

> "The Court: Would you say the fair rental value had the slightest relationship to $12,000 a year?
>
> The Witness: Yes, I would. There was a lot of land leased at that time for around that figure.
>
> The Court: All right.
>
> The Witness: In fact, I personally rented some land *at that figure* at that time. (R. 132)

Furthermore, the petitioner D. M. Haggard testified, and documentary evidence was introduced, showing that he paid $70 an acre of rent for 145 acres of farm land during 1955 and 1956 at a time when farm prices were and are much lower (R. 47-50). The petitioner testified, without any impeachment on cross-examination, that the land being rented for $70 an acre in 1955 and 1956, with no option to purchase, was comparable as to quality of the soil, was in the same locality, and had water costs which were comparable (R. 47, Ex 3). Because the $12,000 paid in 1949 for 160 acres of land results in a per acre rental of $75 per acre, it cannot be said that the payment of $75 an acre for land worth $300 an acre (according to the Tax Court's findings of fact) is "unthinkable". As Mr. Akin testified:

> " . . . at that time, there was a terrific scramble for land in rental. The pattern of occupancy from sale, pattern of sales was

bad and farmers were trying to get land under rental conditions. (R. 132)

To those who come from the cold one crop farm country of East, it probably does seem inconceivable that a good farmer would pay $75 an acre rent for farm land. However, if the Court will take judicial notice that there are 350 days of sunshine each year in Arizona's desert country surrounding and including the subject 160 acres, and consider that two to three crops a year can be and are grown on the same land, such a rent is not unthinkable.

Because respondent's comparison of the percentage of rent with the total consideration is the only examination of the intent of the parties as reflected by the instruments, rather than facts collateral to the instruments, petitioners turn aside from respondent's factual arguments concerning the cases of *Breece Veneer & Panel Co. v. Commissioner,* 7 Cir., 1956, 232 F. 2d 319 and *Benton v. Commissioner,* 5 Cir., 1952, 197 F. 2d 745.

Because pages 8 to 21 of respondent's brief contain a review of facts collateral to the instruments, petitioners temporarily turn aside to his arguments, beginning on page 21, concerning the cases of *Breece Veneer & Panel Co. v. Commissioner,* 7 Cir., 1956, 232 F. 2d 319 and *Benton v. Commissioner,* 5 Cir., 1952, 197 F. 2d 745, cited by petitioners in their opening brief.

It will be recalled that petitioners urged that the Tax Court contravened the rule of *Benton v. Commissioner,* supra, by ascertaining the intention of the parties from economic "facts" alone (Pet. Br. 10). This view was based on specific language from the Tax Court's opinion stating that if the annual payments materially exceed a current *fair rental value* and the total payments made before the option was exercised are disproportionate to the relatively *small final amount* paid to acquire title, petitioner is obtaining as equity *as intended by the parties* and the payments rae in reality applied to an agreed purchase price (R. 19-20). In other words, petitioners took the Tax Court at its word. This is what it said it was doing. However, this is not so says respondent.

When the Tax Court added the phrase "and upon consideration of the record as a whole," in the last paragraph of its opinion, it escaped such criticism.

Petitioners submit that such a phrase is standard equipment in nearly all opinions of good trial judges, and that it is not sufficient when the entire tenor of the opinion indicates clearly that an objective economic test was in fact the basis of the decision. If respondent is correct in saying that the Tax Court did, in reality, go along with *Benton v. Commissioner,* supra, why is it that the Tax Court opinion said the *Benton* case was not controlling here (R. 24). If respondent's view is accepted as correct, there will be very few reversals possible. Furthermore, if this decision of the Tax Court is affirmed, every taxpayer-lessee in Montana, Idaho, Nevada, Arizona, California, Oregon and Washington will be confronted by a District Director of Internal Revenue claiming that the parties intended the lessee to acquire an equity if the lease payments materially exceed current fair rental value and the total payments paid before the option is exercised are disproportionate to the relatively small final amount paid to acquire title. That is the rule announced by the Tax Court which was rejected by the Seventh Circuit in *Breece Veneer & Panel Co. v. Commissioner,* supra.

Regarding the Seventh Circuit's reversal of *Breece Veneer & Panel Co., v. Commissioner,* supra, which rationale regarding fair rental value was relied on here, respondent claims the rationale was not overruled but given implied approval. (Br. 25). This is difficult to follow. How does a U.S. Court of Appeals reverse the Tax Court and at the same time give "implied approval" to the rationale upon which the Tax Court rested its decision. A reading of the *Breece* opinion shows that the court rejected *Judson Mills,* 11 T.C. 25 (1948), one of the same cases relied on by the Tax Court in the instant case, on the ground that it involved a lease of machinery with an option to purchase for a relatively small amount. *Breece Veneer & Panel Co. v. Commissioner,* supra, at 321. Also the *Breece* opinion stated that *Truman Bowen,* 12 T.C.

446 (1949), likewise relied on by the Tax Court herein, was inapplicable, and that *Oesterreich v. Commissioner,* 9 Cir., 1955, 226 F. 2d 798, *Watson v. Commissioner,* 9 Cir., 1932, 62 F. 2d 35; *Jefferson Gas Coal Co. v. Commissioner,* 52 F. 2d 120; all relied on in respondent's brief, were not decisive.

The key to respondent's avoidance of *Breece Veneer & Panel Co. v. Commissioner,* supra, is the statement that:

> "The facts in the case at bar are materially different, in respect to the aforementioned comparison of rents, than those upon which the court reversed in the *Breece case.*" (Br. 26).

Yes, but in whose favor? In the *Breece* case, the lessee agreed to pay $20,000 per year, for a term of five years, renewable for three additional years, and was given an option to purchase the property for $50,000 at the end of the fifth year. Thus, the lessee would pay $100,000 of rent for five years and then be able to purchase for $50,000. Using respondent's argument (Br. 20), the rental payments constituted 66⅔% of the total considerations while in this Haggard appeal, the rental payments ($22,000) only amounted to 46% of the total considerations of $48,000. Also, it is clear that a final payment constituting 33⅓% ($50,000 of total of $150,000 in *Breece* case) is a relatively smaller final payment than the 50% ($24,000 of total of $48,000) required of petitioners in this case. Yet, the *Breece* opinion pointed out that the "amount of rent after five years lacked the substantial sum of $50,000.00 to make the taxpayer the owner. If one-third is a substantial sum, it follows that 50% is more substantial, and therefore a stronger case for petitioners.

On page 26, respondent states that:

> "another rule which taxpayer seeks to glean from the *Breece* decision through its citation of *Helvering v. San Joaquin Co.,* 297 U.S. 496, is that there can be no equity until the option is exercised. (Br. 8). If such were the effect of the *Breece* decision, it would quite plainly, be contrary to this Court's decision in *Oesterreich* and would have to be rejected. However, the Seventh Circuit cited the Supreme Court's decision purely as

dictum and an examination of the latter decision shows it to be of extremely doubtful application to a situation such as is here presented." (Br. 26).

First of all, *Helvering v. San Joaquin Co.,* 297 U.S. 496 (1936) is applicable, it cannot be rejected simply because it is (assuming this to be true) "contrary to this Court's decision in *Oesterreich.* Once a U.S. Court of Appeals concludes that a decision of the U.S. Supreme Court is applicable, it is required, under our system of judicial administration, to follow that decision.

Secondly, the citation of *Helvering v. San Joaquin,* supra, was not dictum. It followed two sentences which referred specifically to the language of Section 23(a)(1)(A) stating:

"The very language of the Statute establishes that it is not applicable to the facts or the evidence in this case. There was no equity until the option was exercised. See *Helvering v. San Joaquin Fruit & Investment Co.,* 297 U.S. 496, 56 S. Ct. 569, 80 L. Ed. 824." *Breece Veneer & Panel Co. v. Commissioner,* supra at 324.

Third, the *Hedvering v. San Joaquin* decision, it is submitted, is authority for the principle that there can be no equity until the oution is exercised. In that case, the question was whether real property was acquired by a "lessee," under a lease-option agreement, when the option was granted or when it was exercised. Mr. Justice Roberts writing for a unanimous court, explained at page 498, why the property was not acquired until the date the option was exercised.

" . . . But the option is admittedly not the same property as the land. So conceding, the respondent still insists that ownership of the option created an interest in the land. This would not be true of a bare option unconnected with a lease; but we are told that because embodied in the lease the agreement became a covenant real and gave the lessee a species of inteerst or property in the land. The weight of authority is to the contrary, . . . "

Also the *Helvering v. San Joaquin* case was cited by the court in

Benton v. Commissioner, supra, but resonpdent argues that it is qualified by the phrase:

> "If the parties in good faith actually intended to enter into a lease contract, then the taxpayer, up until the time that he exercised his option to purchase, acquired no title to or equity in the property." (Br. 26).

But how does this affect this case? The Tax Court made no finding that the parties did not act in good faith.

On page 27 of respondent's brief, it is said that the rule that parties have full liberty to contract as they please is limited by the phrase "Within the limits of reason" which phrase is fully quoted at page 13 of petitioners" opening brief. However, no interpretation of this limitation is given nor are any standards offered to measure the boundaries of the phrase. Respondent is really contending that it means except when a lessee acquires an option to purchase. (Br. 27).

II

Because of this Court's opinion in *Oesterriech v. Commissioner,* supra, that the Tax Court erred in treating the question of intention of the parties as one of fact collateral to the written instrument, petitioner have urged above that respondent's review of the facts from pages 8 to page 21 are irrelevant to the determination of this appeal. However, courts must disagree with one of the opposing sides, and therefore the following reply is given to respondent's factual analysis if the Court deems the facts collateral to the instrument significant.

The first of respondent's factual contentions relating to intent of the parties is found in the first paragraph at page 11 of his brief, and concerns the comparison of total rent to total consideration. To this argument petitioners have already replied. It should be noted that this is a purely economic test. However, respondent dismissed even these contentions by stating in the subsequent paragraph that:

> "However, it is a matter of indifference what the taxpayer did or did not believe. As *Oesterreich* demonstrates, the important consideration is what the parties (p. 802) intended to happen." (Br. 11).

The second factual support for the conclusion that the parties intended that the lessee would acquire an equity is the statement on page 11 of respondent's brief that:

> "It is obvious that, by the $22,000 payments denominated as rent plus the $2,000 payment for the option, the parties intended that the taxpayer would become entitled to full ownership of the property by the payment of an additional $24,000 at the end of a period of less than two years."

Why? This is a patent non sequitur If the parties in the *Breece* case did not so intend when $100,000 of a total of $150,000 (66⅔%) has been paid, why is it obvious in a case where only $24,000 of a total of $48,000 (50%) was paid? And suppose it was agreed that the parties intended that the payment of an additional $24,000 would subsequently entitle the lessee to "full ownership." Does that fact alone convert a lease into a sale? If so, every lease containing an option to buy is a sale under Section 23(a)(1)(A). This same argument was made by respondent in the *Breece* case, supra, and the court rejected it saying at page 323:

> "... Manifestly, one who takes an option does so with the hope of exercising it, but the hope does not create an equity."

Again, petitioners ask the Court to note that the intent of the parties is being discerned from pure economic criteria.

Next respondent says, on page 11, that "quite plainly" it was the $22,000 payments plus the $2,000 option payment which formed the consideration enabling petitioners "to complete the sale" for only $24,000 (Br. 11). To begin with, the phrase "to complete the sale" assumes the answer to the very question before the Court: Did the Tax Court err in determining that the parties intended petitioners to acquire an equity? Even so, what does the phrase "quite plainly" add to the strength of re-

spondent's position? It is a statement of preference or characterization rather than basic argument. And suppose every one agreed the $24,000 did enable the petitioners to acquire the real property by paying $24,000 more in 1950. The same situation existed in the *Benton* and *Breece* cases, supra, and in fact it is inherent in every case involving lease-option agreements. The argument, stripped of refinements, means that all lease-option agreements violate Section 23 (a) (1) (A) because all prior payments enable a taxpayer to complete a transaction for a final payment. Without these prior payments, the terms of the lease-option would not be fulfilled, and the question of this case would not come before a court. This too is another economic test being utilized to infer intent contrary to that expressed in the documents.

Following the above point, respondent states that "the taxpayers, by means of these payments, acquired a real and substantial equity in the property—an equity which made it imperative that he exercise the option *"so long as the value of the property did not fall below $25,000."* In other words, the argument is that the parties intended the petitioners would acquire an equity if the property did not fall below $24,000 when the option date arrived. According to this argument the intention of the parties at the date of executing the lease-option would constitute a "floating" or "evanescent" intention that appears and reappears each year depending on the then existing best guess as to the fair market value on the date when the option may be exercised. The Court, in the *Breece* case, supra, at page 322 said that:

> "The fact that the option was exercised is not indicative of the intention of the parties. It was immaterial that the property proved to be a bargain to the taxpayer. The R.F.C. probably would not have sold the property for $50,000.00 in 1943 . . ."

At page 323 of the opinion, the Breece opinion also said:

> ". . . until the option was actually exercised the R.F.C. was not permitting the taxpayer to have any equity."

This argument of respondent's is another purely objective eco-

nomic test which is being utilized to ascertain the intent of the parties.

Beginning on page 12 of respondent's brief facts and circumstances surrounding the execution of the agreements on February 9, 1948 are submitted to the Court. The first of these notes that the total of annual payments, option payment, and option price, was $48,000 which coincided with the $48,000 which Mr. Butler "sought" as a seller of the property, and which amount he had been offered a week earlier. To this it is replied that it is not what one seeks that matters in the world of dollars and cents. It is what one can get, and obviously Mr. Butler could not get a "sale" for $48,000. Property owners usually list their real property at a high asking price in the hope that some unitiated and trusting soul will offer the sum. In this case, the Tax Court found as fact that people named Talby offered Mr. Butler $48,000 just prior to the date of the transaction with petitioner. However, petitioners have been unable to find testimony of Mr. Butler that he was offered $48,000 by the Talbys. On pages 87 and 88 of the record, Mr. Butler testified, in answer to respondent's questions as follows with respect to the Talby offer:

> "Q. Did anyone offer to buy this property from you?
>
> A. Fellow named Talby and his brother-in-law.
>
> Q. When was that offer made?
>
> A. Oh, they was there about a week before this and they came back two or three times and their father called me up and told me that he would sign the paper and guarantee the payments (63) and everything. One of these boys just come back from service a couple years before, both of them was, as far as that was concerned, and $8,000 he wanted to pay down, according to that, what do you call it there? Says five, but I think it was eight. I thought it was eight at that time. Then the balance of ten equal payments, in other words."

In any event, petitioners suggest that the "fact" of an offer to buy for $48,000 from another individual (assuming one existed) adds nothing to an interpretation of the intention of the

parties to an entirely separate and distinct transaction. This is much more remote than the facts of the *Breece* case where Mr. Breece, as President of the Company, wrote the R.F.C., two years before the lease-option agreement was executed, that he was interested in purchasing the property for $100,000. Yet this prior dealing by the same taxpayer which ultimately acquired the property via the lease-option agreement was not considered by the Seventh Circuit as reflecting intention to purchase insofar as the lease-option agreement was concerned. Thus, it is difficult to understand how the intention of Mr. Butler insofar as the Talby uncompleted transaction would have any bearing on the intention of Mr. Butler and Mr. Haggard as expressed in written instruments.

Following the above argument, the respondent, on page 13, emphasizes that intention is shown by Mr. Butler's belief on February 9, 1948 that the legal effect of the transaction was a sale. But how does such a view square with the respondent's citation of the *Osterreich* case, supra, at page 801 wherein this Court said:

> ". . . If the parties enter into a transaction which they honestly believe to be a lease but which in actuality has all the elements of a contract of sale, it is a contract of sale and not a lease no matter what they call it nor how they treat it in their books . . ."

Would not the converse also be true? If the parties (Mr. Butler only) honestly believe the transaction to be a sale but which in actuality has all the elements of a lease, it is not a lease no matter what Mr. Butler (a layman) calls it? Also, how does such a contention fit with respondent's prior argument, on page 11 of his brief, that ". . . it is a matter of indifference what the taxpayer believed." How does the belief of one party to the transaction support an "intention" that the legal effect was a sale when respondent is also argunig, on page 9 of his brief, that the intention of the parties cannot be determined unilaterally? In this regard it is significant to note that the Tax Court made no finding of fact that Mr. Butler "intended" a sale. It simply found that the parties

intended that petitioners would acquire an equity in the real property. The reason it did not make such a finding regarding Mr. Butler's belief is best illustrated by the following testimony of Mr. Butler.

> "The Court: Can you tell me why or wherefor or just what happened, if you know, as to how this got changed over from a $48,000 sale to a lease for $10,000 for a little less than the entire year '48, $12,000, '49, $2,000 option and $24,000 purchase price? What happened, if you remember, that moved it from one to the other?
>
> The Witness: I discussed it, they discussed it.
>
> The Court: Who discussed it.
>
> The Witness: Mr. Merrell, Mr. Haggard, and myself, and they agreed and *I agreed to it at that time that way.*" (R. 95-96). Emphasis supplied.

In short, Mr. Butler specifically agreed, after discussing the matter, to lease the 160 acres for two years and grant petitioners an option to buy at a purchase price of $24,000 in 1950 before he signed the instruments.

On page 14 and 15 of his brief, respondent continues with Mr. Butler's belief as to the legal effect of the transaction. Petitioners submit that for the reasons stated in the preceding paragraph, his belief is not relevant. Petitioners also submit that the question to be determined by the trial court was whether the transaction was, in law, a sale or a lease, and the belief of laymen concerning the legal effect of their transaction adds very little to the answer to that question. However, even if it did, the contrary belief of petitioners would balance out the effect of the other party's belief as to legal effect. The truth of the matter is that the parties, in a lease-option agreement, often view the transaction differently. Possibly that is why this Court, in the *Osterreich* case, was only interested in the instrument and not what the parties honestly believed the transaction constituted.

Should the Court adopt the view, urged by respondent, that

the testimony of one party concerning the belief as to the legal effect of the transaction, regardless of what the terms of the instrument provide, is reflective of intention of the *parties,* which respondent agrees cannot be determined unilaterally, there will be a frightful deluge of these cases. The reason, of course, is that most of the "lessors" in lease-option agreements would prefer to treat the proceeds as capital gain rather than ordinary income, and will be bound to give their opinion evidence concerning the legal effect of the transaction to protect the capital gain status of the transaction.

Insofar as the testimony of Mr. Butler, found on pages 15 and 16 of respondent's brief, is concerned, it can hardly be said to reflect a firm belief that the legal effect of the transaction was a sale because of his statement on page 16. There Mr. Butler said he was convinced that it was "more or less all right." Someone who takes a step on a "more or less" basis cannot be said to be of the fixed belief that the legal effect of the transaction was a sale. These words indicate an individual who had serious reservations that the transaction was a sale.

After setting forth Mr. Butler's testimony, respondent contends that Mr. Butler's intention to sell was "corroborated" by the treatment of the transaction as a sale on his 1948 Federal income tax return filed a month or so after the lease and option were executed. Surely respondent is not seriously suggesting that the incidence of taxation can be determined by the characterization of a transaction on one taxpayer's return. And even if the Court would agree, would not such a factor be cancelled out in view of the fact that the other party to the transaction reported the transaction as a lease on his return? This argument illustrates forcefully that both the Commissioner and the Tax Court have wholly disregarded everything except the alleged intention of one of the parties which is ascertained from facts collateral to the instruments.

The crux of respondent's argument is that petitioners did not

meet their alleged burden of proving it was Mr. Butler's intent that the legal effect of the transaction was to be a lease (Mr. 16). What respondent's review of the facts reveals however, is that he believes this intent must be proved by facts corollary to the instrument. This view is incorrect. *Oesterreich v. Commissioner,* supra. However, even if such an argument was sound, the testimony of Mr. Butler's shows that he entered into a lease transaction with petitioners, after discussing it, and after agreeing "to it at that time that way" (R. 96). He wanted to get his money out of the real property as fast as he could, and the only way that could be done was to lease it to Mr. Haggard for two years with an option to buy. (R. 98-99). That is why he did not "sell" to different people who wanted to trade a mortgage, or an apartment house, or twenty acres of land, or a Ford (R. 87). Mr. Butler entered into the lease-option transaction with his eyes wide open.

On page 18, respondent contends there is nothing inconsistent about treating the transaction as a sale on February 9, 1948 and the fact that Mr. Butler borrowed $12,000 on the property fourteen months after he "sold" it. Petitioners submit it is inconsistent with a conclusion that a sale occurred on February 9, 1948, and the belief of Mr. Butler that the legal effect of the transaction was a sale. A vendor of real property normally does not mortgage the property after it has been sold.

Again on page 18, respondent urges "several economic factors" as reflecting the intent of the taxpayer (Br. 18). The first is the Tax Court's finding of fact that the fair rental value was $5,000 in 1949. The case of *Breece Veneer & Panel Co. v. Commissioners,* supra, rejected such economic data as reflecting the intent of the taxpayer to purchase. Also, a reading of Mr. Akin's testimony will reflect that such a finding is contradicted by his other testimony (R. 132-133).

At page 19, respondent emphasized that the taxpayer "utilized only 90 of the 160 acres for crops in 1949." This is misleading because Mr. Haggard also testified that in 1949 he ran cattle

on that portion of the 160 acres on which there was not enough water for crops (R. 62). How can a farmer cultivate more land in a desert area than 90 acres of 160 acres if there is not enough water for more than 90 acres? The grazing of cattle on the balance of the land shows its full utilization.

Lastly in the factual review, respondent argued that the Tax Court's determination of fair market value of $48,000 for the land on February 9, 1948 was supported by:

(1) Mr. Butler's original purchase price of $40,000 paid in 1945.

(2) Mr. Butler's listing of the property for $48,000.

(3) The alleged failure of taxpayer's expert to include certain water rights in his appraisal.

As far as No. (1) is concerned, it must be clear that the logical or inferential relationship between what one pays for real property in 1945 and its fair market value three years later is slight. This is particularly true when the record shows that Mr. Butler still owed $22,000 to Mr. Ewalt in 1948 and $6,500 to the National Farm Loan Association after having made two annual payments of $5,000 (R. 91, 97, 100). In short, Mr. Butler paid only $1,500 down when the property was purchased for $40,000, and the purchase price of $40,000 must be viewed in that light. Nor does the listing of the property for $48,000 have any real relationship to fair market value. There is a big difference between an asking price and the price one will sell for if the cash can be obtained in two years by means of a lease and a subsequent sale. Finally, the record does not sustain the Tax Court's finding that Mr. Akin's valuation of $21,750 on February 8, 1948 could not be accepted because he had given no consideration to the significant factor of the right to the use of water which was essential to the production of the land "because" of his assumption that such right was not appertinent to the land (R. 22). From the above finding of the Tax Court, it would appear

that Mr. Akin failed to value the right to obtain water on the land. The record is otherwise.

Mr. Akin testified that one of the factors considered by him in valuing the 160 acres was that the land received three and one-half acre feet per acre from the Salt River Valley Water User Association from *their* pumps which delivered the water into irrigation ditches (R. 112-115). He specifically testified that there were two other private wells, but that those wells provide all of the water from which there was firm water right appurtenant to *that* land (R. 115). He testified that he valued the subject real property without considering the well because the water therefrom was not appurtenant to the Butler land (R. 137). The Tax Court, assuming the water from that well to be the source of water for the property, rejected Mr. Akin's valuation of the land, saying the record failed to show whether the right was or was not appurtenant to the land. (R. 22).

Furthermore, even if the Tax Court had been correct, Mr. Akin's testimony provided the fair market value. He said:

> "But the water from the other wells is appurtinent to the land. The land is a fee simple title, fee simple title to the land includes certain water. The Peninsular and Horowitz Water is a part of the fee simple title of that land, it is appertinent to the land, cannot be separated from it. This other we are talking about is not appertinent to the land, can be separated from it, and therefore is something separate (116) and hence it should be valued separately which I did, and the value of the water, *if you are going to consider it then, the value of the interest in the well should be added to my appraisal;* if you are going to take that, it is just as separate as though it were a truck or something else that could be separated from the land, you see" (R. 136)

In view of Mr. Butler's testimony that he had a $2,200 well "again that property" (R. 83-84), the $21,750 appraisal of Mr. Akin's could be added to the $2,200 for a total fair market value on February 8, 1949, of $23,950 even if the water from the questioned well had been appurtenant to Mr. Butler's land.

CONCLUSION

The decision of the Tax Court should be reversed.

Respectfully submitted,

W. Lee McLane, Jr.
Nola McLane

Counsel for Petitioners

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